



DEPARTMENT OF THE AIR FORCE  
HEADQUARTERS UNITED STATES AIR FORCE  
WASHINGTON 25, D. C.

#35

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Los Angeles 54, Calif.

SAPC/6851

COPY 1 OF 2

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17 June 1957

SUBJECT: Report on Price Redetermination Audit  
Contract FL 3011, Items 1, 2, 3, 4, 5, 6, 9a; 8 and 9  
Westinghouse Electric Corporation  
Baltimore, Maryland

TO: Contracting Officer

REF: Letter of 8 March 1957, Nr. 13789

1. Purpose of Examination. An examination has been made of the historical and estimated costs included in the contractor's proposal for price redetermination of the subject contract items. The examination was made to determine the accuracy of the historical costs and to furnish pertinent information developed relative to costs estimated by the contractor.

2. Results of Examination. The contractor proposed a cost of \$1,484,809, consisting of \$1,035,785 of incurred costs to 31 July 1956, and \$449,024 estimated costs to complete. As the result of an examination we have questioned \$77,209, and have developed other information for consideration by the contracting officer. These items are briefly summarized below and explained in detail in the referenced schedules. We were unable to provide the specific information requested on additional items proposed under Contract Items 5, 6, and 9 for the reasons explained in Schedule 1.

a. Schedule 2 - Unsupported Variance Factor: \$39,235. The contractor did not support a rate of 30% used to convert recorded standard factory labor and overhead to actual for use in the proposal.

b. Schedule 3 - Excessive General and Administrative Expenses: \$16,856. The rate used by the contractor is greater than rates computed by the auditor.

c. Schedule 4 - Estimate to Complete: \$21,118. Contractor's estimate to complete, exclusive of general administrative expenses, exceeds the sum of costs recorded from 1 August 1956 to 31 March 1957 and an estimate of costs to be incurred after 3 March 1957, also prepared by the contractor.

Report on Price Redetermination Audit, Contract FL 3011, Items 1, 2, 3, 4, 5, 6, 9a; 8 and 9, Westinghouse Electric Corporation, 17 June 1957 (Cont)

d. Schedule 5 - Material Costs. Qualified acceptance of the material costs claimed is recommended.

e. Schedule 6 - Profit. The amount of profit included in the proposal at the rate of 7% of proposed costs is equivalent to 9.07% of the cost base contained in the amended contract prices of items subject to price redetermination.

3. Discussion with Authorized Contractor Officials. The auditor did not have the opportunity of discussing all of his findings with the contractor's officials. However, the contractor was informed that the variance factor and the rate for general and administrative expenses and the estimate to complete would be areas that would be questioned.

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6 Incls  
Schedules 1 through 6

Director, Western District  
Auditor General

Schedule 1  
Page 1 of 2

Westinghouse Electric Corporation  
Contract FL 3011

SUMMARY OF CONTRACTOR'S PROPOSAL AND COSTS QUESTIONED BY AUDITOR

	<u>Contractor's Proposal</u>			<u>Costs Questioned by Auditor</u>		
	<u>Total</u>	<u>Incurred Costs To 31 Jul 1956</u>	<u>Estimate To Complete</u>	<u>Total</u>	<u>Incurred Costs</u>	<u>Estimate To Complete</u>
<u>Costs</u>						
Items 1, 2, 3, 4, 5, 6, and 9a	\$1,443,855	\$1,008,994	\$434,861	\$74,128	\$51,021	\$23,107
Item 8	28,132	26,522	1,610	(542)	142	(684)
Item 9	12,822	269	12,553	3,623	1	3,622
Total Proposed Cost	\$1,484,809	\$1,035,785	\$449,024	\$77,209	\$51,164	\$26,045

Recapitulation of Costs Questioned

Conversion or Adjustment Factor - Schedule 2	\$39,235	\$39,235	-
General and Administrative Expense - Schedule 3	16,856	11,929	\$ 4,927
Manufacturing Cost - Schedule 4	21,118	-	21,118
Total	\$77,209	\$51,164	\$26,045

Schedule 1  
Page 2 of 2

Westinghouse Electric Corporation  
Contract FL 3011

SUMMARY OF CONTRACTOR'S PROPOSAL AND COSTS QUESTIONED BY AUDITOR

NOTES:

1. Contract Item 6

Costs were not segregated in the records for the Contract Items of the contractor's proposal except for Items 8 and 9, and a small portion of Item 6. For this reason it was not possible to determine and separately report the cost incurred for Item 6. The separate presentation in contractor's proposal for Item 6 was arrived at as follows:

The cost of each spares item was estimated. The total of the estimates is shown in the proposal as the total cost for Item 6. The portion which could be identified as relating to spares by analysis of data supporting the cost ledger was shown in the proposal as costs incurred to 31 July 1956, the remainder as the estimate to complete.

2. Additional Items under Contract Items 5, 6, and 9

These additional items were included in the price redetermination proposal, but contract coverage had not been provided. Their costs were not recorded separately in the records and it was therefore not possible to determine and report the incurred costs separately.

The auditor was furnished, but has not separately analyzed, the following figures pertaining to these items, presumably in relation to contract coverage:

	<u>Item 5</u>	<u>Item 6</u>	<u>Item 9</u>	<u>Total</u>
Manufacturing Costs	\$1,660.37	\$44,121.02	\$203.70	\$45,985.09
General & Administrative @ 12.6%	209.20	5,559.25	25.67	5,794.12
	\$1,869.57	\$49,680.27	\$229.37	\$51,779.21
Fee - 7%	130.87	3,477.62	16.05	3,624.54
Total	<u>\$2,000.44</u>	<u>\$53,157.89</u>	<u>\$245.42</u>	<u>\$55,403.75</u>

Schedule 2  
Page 1 of 1

Westinghouse Electric Corporation  
Contract FL 3011

COMMENTS ON VARIANCE FACTOR

Factory labor and overhead are recorded in the ledger accounts on a standard costing basis. The amount of \$170,023 included in contractor's proposal for costs incurred to 31 July 1956 for Items 1, 2, 3, 4, 5, and 9a, was obtained by increasing the recorded standard cost of \$130,788 by a variance factor of 30%, or \$39,235.

Contractor's representative stated that the purpose of applying this factor was to convert the recorded amount to a cost-type contract billing basis.

The inclusion of this adjustment in the price redetermination proposal should have been fully and mathematically supported. Such support was not furnished. The auditor was advised that the cognizant service auditor was familiar with the factor. Data supplied by the latter from financial statements and other sources was inconclusive, since the service audit of overhead had not been completed, but indicated a rate substantially less than 30%.

The contractor was informed upon conclusion of the audit that he would have the opportunity of submitting supporting data at the negotiations. Such data should be subjected to audit review, including consideration of questions on the matter contained in the auditor's working papers.

Schedule 3  
Page 1 of 2Westinghouse Electric Corporation  
Contract FL 3011COMPUTATION OF AMOUNT OF GENERAL AND ADMINISTRATIVE EXPENSE QUESTIONED

	<u>Total</u>	<u>Items 1, 2, 3, 4, 5, 6, and 9a</u>	<u>Item 8</u>	<u>Item 9</u>
Amount of G&A included in proposal for conversion or adjustment factor questioned - \$39,235 x 12.6%	\$ 4,944	\$ 4,944	--	--
Difference between proposed rate of 12.6% and auditor's 1955 rate of 10.5%, or 2.1% x 1955 costs of \$113,416	2,381	2,381	--	--
Difference between proposed rate of 12.6% and auditor's 1956 rate of 12.0%, or 0.6% x 1956 costs to 31 July 1956 of \$767,229	<u>4,604</u>	<u>4,461</u>	<u>\$142</u>	<u>\$ 1</u>
Total Amount Questioned - Incurred Costs to 31 July 1956	<u>\$11,929</u>	<u>\$11,786</u>	<u>\$142</u>	<u>\$ 1</u>
Estimate to Complete:				
Amount of G&A applied by contractor at rate of 12.6% to estimate costs of \$398,778	\$50,246	\$48,661	\$180	\$1,405
Amount of G&A applied by auditor at rate of 12% to costs of \$377,660	<u>45,319</u>	<u>44,116</u>	<u>246</u>	<u>957</u>
Amount Questioned - Estimate to Complete	<u>\$ 4,927</u>	<u>\$ 4,545</u>	<u>\$(66)</u>	<u>\$ 448</u>
Total Amount of G&A Questioned	<u><u>\$16,856</u></u>	<u><u>\$16,331</u></u>	<u><u>\$ 76</u></u>	<u><u>\$ 449</u></u>

Schedule 3  
Page 2 of 2

Westinghouse Electric Corporation  
Contract FL 3011

COMPUTATION OF AMOUNT OF GENERAL AND ADMINISTRATIVE EXPENSE QUESTIONED

Explanation of General and Administrative Expense Rates

The pattern for settlement of contractor's overhead under cost-type contracts has been the use of negotiated rates. The last G&A rate negotiated was 9.9% for the effective period 1 April 1955 to 31 March 1956, based substantially on historical costs for the fiscal calendar year 1954. With the discontinuance of negotiation for prospective periods the next negotiation will be for the retroactive period 1 April 1956 to 31 December 1956, based on calendar year 1956 costs.

The contractor used a rate of 12.6% in the entirety of proposal, stated to have been a computed 1956 rate based on eight months actual and four months estimate. Since separate rates for 1955 and 1956 are properly applicable, such separate rates have been used in this report.

The rate of 10.5% used for 1955 costs was determined in consultation with the cognizant service auditor as representative of what the negotiated rate would have been had a retroactive negotiation basis been in effect for the year 1955.

The rate of 12% for 1956 was also determined in consultation with the cognizant service auditor as the estimate of the rate that will be negotiated on contractor's proposed rate of 14.3% contained in his overhead rate proposals for cost-type contracts for the period 1 March 1956 to 31 December 1956. At the time of the price redetermination examination, the 1956 overhead audit had not been completed. The 1956 rate was applied by the auditor to the relatively small amount of costs incurred in 1957.

Schedule 4  
Page 1 of 2Westinghouse Electric Corporation  
Contract FL 3011EVALUATION OF CONTRACTOR'S ESTIMATE TO COMPLETE

	<u>Items 1, 2, 3, 4, 5, 6 and 9a</u>	<u>Item 8</u>	<u>Item 9</u>	<u>Total</u>
<b>Contractor's Estimate to Complete in Proposal:</b>				
Total manufacturing cost	\$386,200	\$1,430	\$11,148	\$398,778
General & administrative expense at 12.6%	<u>48,661</u>	<u>180</u>	<u>1,405</u>	<u>50,246</u>
Total	\$434,861	\$1,610	\$12,553	\$449,024
Recorded Costs 1 Aug 1956 to 31 Mar 1957 (See Footnote a)	\$351,798	\$2,048	\$ 7,974	\$361,820
<b>ADD:</b>				
Contractor's estimate of remaining costs to complete at 31 Mar 1957 (See Footnote b)	<u>15,840</u>	<u>--</u>	<u>--</u>	<u>15,840</u>
	\$367,638	\$2,048	\$ 7,974	\$377,660
General and administrative expense at rate of 12% used by auditor (Explanation in Schedule 3)	<u>44,116</u>	<u>246</u>	<u>957</u>	<u>45,319</u>
Total	\$411,754	\$2,294	\$ 8,931	\$422,979
<u>Amount Questioned</u>				
Excess of contractor's estimate as of 31 Jul 1956:				
Manufacturing cost	\$ 18,562	\$ (618)	\$ 3,174	\$ 21,118
General and administrative expense	<u>4,545</u>	<u>( 66)</u>	<u>448</u>	<u>4,927</u>
Total (See Footnote c)	\$ 23,107	\$ (684)	\$ 3,622	\$ 26,045



Schedule 4  
Page 2 of 2

Westinghouse Electric Corporation  
Contract FL 3011

EVALUATION OF CONTRACTOR'S ESTIMATE TO COMPLETE

Footnotes:

- a. The amount of \$351,798 includes a 30 November 1956 transfer from another contract in amount of \$48,029 for parts acquired under Purchase Order 86B-37446. This is referred to the Contracting Officer for his consideration since the propriety of the charge was not ascertainable.
- b. Contractor's estimate of remaining costs to complete as of 31 March 1957, \$15,480, covered the following:

Estimated cost relating to (1) completion of modification program and (2) check out and test of two systems prior to shipment.  
2,400 hours at \$6.60 for labor and overhead

The following further information was furnished: The price redetermination proposal includes \$10,000 (\$8,000 for material plus \$2,000 for G&A and Profit) for replacement of four high priced system components. Expenditure for replacement has not yet occurred. Should such expenditure actually occur, however, it would appear that it should be considered at a subsequent redetermination rather than the present one, in accordance with the provisions of Part VI - Inspection - of the contract.

- c. The questioned amount of \$26,045 is subject to the following:
- (1) To increase for value of residual material purchased and/or fabricated for the contract items of the proposal. This and the questioned title to, or residual value of, tools and test equipment are referred to the Contracting Officer for consideration.
  - (2) To possible decrease should the contractor at the negotiations be able to justify any portion of the variance factor explained in Schedule 2. It is estimated that the amount questioned would be decreased by about \$300 for each 1% of the factor that could be justified. For example, if a factor of 8% could be justified, the amount questioned would be decreased by about \$2,400.

Schedule 5  
Page 1 of 1

Westinghouse Electric Corporation  
Contract FL 3011

COMMENTS ON MATERIAL COSTS

The auditor examined recorded charges of significant amounts. The purchase orders for these items were identified to the contract; however, since the contractor has not prepared a bill of material to establish the requirements for the contract, the auditor was unable to verify that the materials charged to the contract represent actual requirements.

Part XVI of the contract requires advance notification to, and the prior written consent of, the contracting officer for subcontracts in excess of \$25,000. The following bore no evidence of the required approval:

Purchase Order 86 CB 75860 dated 1 Mar 1956.....\$74,250

Purchase Order 86 BA 48921 dated 6 Feb 1956.....\$81,529

Purchase Order 86 BA 48921 increased.....\$25,771

Westinghouse Electric Corporation  
Contract FL 3011

COMPUTATION OF RELATIONSHIP OF PROFIT CLAIMED IN  
PRICE REDETERMINATION PROPOSAL TO COSTS IN ORIGINAL CONTRACT PRICE AS AMENDED

Total contract price, per Definitive Contract and Amendments 1, 2, 3, and 4 for Items 1 through 9	\$1,310,572
Less Item 7 not included in price redetermination proposal	<u>139,649</u>
	\$1,170,923
Add amount submitted by contractor for the additional items under Contract Items 5, 6, and 9, which were included in the price redetermination proposal but for which contract coverage had not been provided	<u>55,404</u>
	\$1,226,327
Costs in contract price (based on 7% fee) - $\$1,226,327 \div 1.07 =$	<u>\$1,146,100</u>
Profit or fee proposed in price redetermination proposal (7% of total proposed cost)	<u>\$ 103,937</u>
Percentage of profit claimed to costs in contract price	<u>9.07%</u>